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# Advisory

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**Category:** Regulatory & Legislative

**NOTICE\***

**Subject:** Control in fact

**No:** 2007 – 02

**Issued:** October 2007

**Introduction:** The issue of whether a person controls an entity is relevant in various circumstances throughout the federally regulated financial institution (FRFI) statutes<sup>1</sup> including, for example, provisions relating to ownership of a FRFI, investment rules, and the definition of a related party for the purposes of the self-dealing provisions. The definition of “control” in the FRFI statutes includes both the concepts of “control in law” (also known as *de jure* or legal control) and “control in fact” (also known as *de facto* control).

Subsection 3(1) of each of the FRFI statutes provides that there is control in law where:

- (a) securities of the body corporate to which are attached more than 50 per cent of the votes that may be cast to elect directors of the body corporate are beneficially owned by the person and the votes attached to those securities are sufficient, if exercised, to elect a majority of the directors of the body corporate;
- (b) more than 50 per cent of the ownership interests, however designated, into which the unincorporated entity, other than a limited partnership, is divided are beneficially owned by that person and the person is able to direct the business and affairs of the entity, and
- (c) the person is the general partner of a limited partnership.

That subsection also defines control in fact as the control arising from a person having any direct or indirect influence that, if exercised, would result in control in fact of the entity. This Advisory provides guidance on factors that OSFI considers in determining whether control in fact exists in a particular situation. The factors reviewed in this Advisory are not exhaustive and no factor is necessarily definitive in making a determination.

Without limiting the discretion of the Minister of Finance, when assessing the application of a person for the Minister’s approval to acquire more than 10% of a class of shares of a large bank or certain large insurance companies, and formulating a recommendation in respect of such

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<sup>1</sup> FRFI statutes refer to the *Bank Act*, the *Insurance Companies Act*, the *Trust and Loan Companies Act* and the *Cooperative Credit Associations Act*.



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application, OSFI will consider the policy objectives set out in the Guidelines<sup>2</sup> issued by the Minister pursuant to subsection 3(4) of the *Bank Act* or the *Insurance Companies Act*, as the case may be, taking into account the factors set out in the Guidelines.

**Legislative References:**

Paragraph 3(1)(d) of the *Bank Act*, the *Trust and Loan Companies Act*, and the *Insurance Companies Act*

Paragraph 3(1)(e) of the *Cooperative Credit Associations Act*

**Definitions:** In this Advisory,

“governors” means a person or group of persons who, by law, contractual arrangement or otherwise, are vested with the power to manage or supervise the management of the business and affairs of an entity, (e.g. board of directors, partners, trustees and their committees).

“ownership stake” means shares held in a body corporate or ownership interests, however designated, held in an unincorporated entity.

“senior officer” means

- (a) in relation to a body corporate, the chief executive officer, secretary, treasurer or controller, or any other natural person who is designated as an officer of the body corporate by by-law or by resolution of the directors of the body corporate and who is reporting directly to the board of directors or to the chief executive officer, and
- (b) in relation to any other entity, any natural person who performs functions for the entity similar to those performed by a person referred to in paragraph (a), or any other natural person reporting directly to the Governors of the entity or to a person who performs functions for the entity similar to a chief executive officer of a body corporate.

**Interpretation:** The provision in the FRFI statutes<sup>3</sup> that defined the concept of control in fact does not require control to actually be exercised; all that is required is the presence of influence that, if exercised, would allow the person to control the entity. Where the person’s ability to influence is contingent upon the occurrence of an event that is outside of that person’s control, OSFI is of the view that control in fact would not result until the occurrence of that event.

Generally, if a person controls in law an entity, OSFI assumes that the person also controls in fact, unless there are some indicia that control in fact of the entity rests with one or more other persons.

Consistent with case law and past situations that OSFI has examined, OSFI generally considers

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<sup>2</sup> *Guidelines Respecting Control in Fact for the Purpose of 377(1) of the Bank Act* (SOR/2002-163) and *Guidelines Respecting Control in Fact for the Purpose of 407.2(1) of the Insurance Companies Act* (SOR/2002-162).

<sup>3</sup> See paragraph 3(1)(d) of the *Bank Act*, the *Trust and Loan Companies Act*, and the *Insurance Companies Act*, and paragraph 3(1)(e) of the *Cooperative Credit Associations Act*.

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the following in determining whether a person controls in fact an entity:

1. The representations made by the person to other stakeholders (shareholders, unitholders, customers, etc.). For example, in *Silicon Graphics Ltd. v. Canada*<sup>4</sup>, the Federal Court of Appeal relied, in part, on evidence that the person did not want to be in control of the entity named Alias, in finding that the person did not control in fact that entity. The court noted “Additionally, there is evidence that Silicon US did not want to be in control of Alias because it did not want to be viewed as partisan to other customers who were competitors of Alias. Silicon US never tried to install a person in management or as a director.”
2. The types of influence that could lead to a person having control in fact of an entity, namely:
  - influence exercised through ownership of the entity;
  - influence over the governors of the entity;
  - influence over the operations of the entity;
  - influence based on economic dependence of the entity, and
  - influence over the life of the entity.
3. The degree of direct or indirect influence that the person exercises. The determination of the degree of influence that, if exercised, would result in control in fact of the entity is subjective. Accordingly, OSFI will make this assessment on a case by case basis taking into consideration the following indicia for each type of applicable influence:

**Influence exercised through ownership:** Any ownership stake confers some degree of influence to their holders. The degree of influence conveyed varies depending on the size and/or value of the ownership stake, and the rights, privileges, restrictions and conditions attached thereto (e.g., voting, non-voting, retractable, etc.). Thus, OSFI will generally consider the following factors to determine whether a person’s ownership stake confers influence that extends beyond the safeguarding of that person’s rights and interests in the entity.

- (a) Ownership stake: The size and/or value of the person's ownership stake in regard to other stakeholders, and the rights, privileges, restrictions and conditions attached to the shares or ownership interests beneficially owned by the person or entities controlled by the person. For example, a person is more likely to have significant influence where the person is the only one to have a major ownership stake in the entity, that is:
- the aggregate of the shares or ownership interests of any class, which has a voting right, that are beneficially owned by the person and that are beneficially owned by any entity controlled by the person is more than 20% of the outstanding shares or ownership interest of that class outstanding; or
  - the aggregate of the shares or ownership interest of any class, which does not have a voting right, that are beneficially owned by the person and that are beneficially owned by any entity controlled by the person is more than 30% of the outstanding shares or ownership interest of that class outstanding.

However, in the absence of other contributing factors, a major ownership stake may not necessarily constitute control in fact. For example, if a person holds 49% of the voting

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<sup>4</sup> [2002] F.C.J. No. 922 (C.A.) at para. 68.

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shares as well as over 70% of the shareholder's equity of an entity, this may not result in the person holding control in fact of the entity if the person does not have a voting majority on any resolution, and there are:

- no contractual rights that would give the person a say in the composition or decision of the board of directors of the entity;
- no special relationships between the person and other shareholders that would suggest that the other shareholders would be compliant with the person's view regarding the business and affairs of the entity, and
- no circumstances that would give to the person the right to decide on any key issues, make strategic decisions, or run the day-to-day operations of the entity.

Also, a person may have significant influence in spite of having a very small or even no ownership stake in the entity. In *Société Foncière D'Investissement Inc. v. R.*<sup>5</sup>, an individual, who held less than one per cent of the voting shares, was found to control in fact a company because his two daughters held the remaining shares, and through shareholder resolutions, the individual had broad management powers over the operations of the entity, including signing, spending and borrowing authorities.

- (b) Involvement of other stakeholders: The role and involvement (or lack of involvement) in the business and affairs of the entity by other stakeholders. For example, a person with a major ownership stake in an entity is more likely to be found to control in fact the entity where the other persons do not fully avail themselves of the rights attached to their ownership interests, and, as a result, are not likely to contest the actions of the person with the major ownership stake in the entity.
- (c) Rights/options to increase an ownership stake: Influence arising as a result of the person holding:
- options or rights to acquire additional shares of, or ownership interest in, the entity that, if exercised, would materially increase the size and/or value of the person's ownership stake,
  - rights to cause the redemption or cancellation of shares of, or ownership interest in, the entity that, if exercised, would materially increase the size and/or value of person's ownership stake, or
  - rights to cause or effect changes in voting rights attached to the shares of, or ownership interest in, the entity that, if exercised, would materially increase the person's voting rights.
- (d) Relationship with other stakeholders: The relationship (family, contractual, legal, or social) between the person and other stakeholders, which may allow the person to exert economic, financial or moral influence over other stakeholders. For example, in *International Mercantile Factors Ltd. v. The Queen*<sup>6</sup>, the existence of a shareholders' agreement that allowed one shareholder to prevent a change in the composition of the board of directors was a factor in the control determination.

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<sup>5</sup> [1996] 3 C.T.C. 2537.

<sup>6</sup> [1990] F.C.J. No. 515.

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**Influence over the governors:** This refers to the influence a person has over the governors to have his or her will prevail. For example, in *Silicon Graphics*, the Federal Court of Appeal referred to a “clear right and ability to effect a significant change in the board of directors or the powers of the board of directors or to influence in a very direct way the shareholders who would otherwise have the ability to elect the board of directors”.<sup>7</sup> In assessing the degree of such influence, OSFI will generally consider:

- (a) Composition of the governors: The ability of a person to appoint, block the appointment of, remove or replace one or more of the governors. For example, where a person has both a major ownership stake in an entity and the power to designate a significant number of governors, there is a greater likelihood that control in fact is present. Furthermore, where a person has the authority to remove and replace a majority of the governors, OSFI considers that this power could be used *in terrorem* to substantially influence the governors.
- (b) Committees of the governors: The role and involvement of the person in committees of the governors having regard to the composition and structure of a committee, as well as the voting arrangements of a committee.
- (c) Relationship with governors: The relationship (family, contractual, legal, or social) between the person and the governors, which may allow the person to exert economic, financial or moral influence over the governors.
- (d) Special voting rights: The attributes of the shares or other ownership interests, or the agreements between stakeholders, that confer to the person any special rights for either the appointment of governors, the adoption of resolutions or decision by the governors, or any special rights to block or veto decisions of the governors. While, in most cases, the ability to block or veto certain decisions will not alone constitute control in fact, there may be circumstances where the veto power is so broad as to influence the entity’s actions, and could lead to a finding of control in fact. In addition, the possession of a casting vote (i.e., an additional vote given to break a voting stalemate) for decisions by the governors could be construed as control in fact. For example in *Multiview Inc. v. Canada*<sup>8</sup>, where two parties had equal ownership and representation on the board, the Tax Court emphasized the absence of a casting vote in finding that neither party had control of the corporation.

**Influence over the operations:** This refers to the ability of a person, other than a governor or senior officer, to materially shape the operations of the entity. In assessing the degree of such influence, OSFI will generally consider:

- (a) Involvement in management: The ability of the person to appoint, block the appointment of, remove or replace senior officers of the entity. Where the person is not a governor or senior officer, the person’s role and involvement in:
  - making strategic decisions regarding the business and affairs of the entity, including business plans, significant capital expenditures, dividend policies or the issuance of securities of the entity,
  - managing and running the day-to-day operations of the entity, or

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<sup>7</sup> *Silicon Graphics Ltd. v. Canada* [2002] F.C.J. No. 922 (C.A.) at para. 67.

<sup>8</sup> [1997] T.C.J. No. 713.

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- determining or constraining the business activities of the entity.
- (b) Relationship with senior officers: The relationship (family, contractual, legal, or social) between the person and senior officers, which may allow the person to exert economic, financial or moral influence over senior officers, other than in the carrying out of the person’s duty as a governor. This would include whether one or more of the senior officers holds, or once held, similar positions with the person or entities controlled by the person.
- (c) Performance of key functions: The level of authority and accountability of the person in discharging his/her duties or functions. For example, unless a person has a duty to act in the best interests of another person, the person is more likely to exercise significant influence where the person has the discretionary authority to manage the business and affairs of the entity, (e.g., sign cheques and contracts, purchase and sell the entity's property, borrow money on behalf of the entity, conclude agreements in respect of claims against the entity, etc.).
- (d) Involvement of others: The role and involvement (or lack of involvement) in the business and affairs of the entity by other persons in a position of authority (e.g., other senior officers, governors.). For example in *Mimetix Pharmaceuticals Inc. v. Canada*<sup>9</sup>, a U.S. corporation that held 50% of the shares of Mimetix was found to be in control of Mimetix because its CEO was a director of Mimetix and controlled the day-to-day operations of Mimetix while its other directors had little knowledge of, or involvement with, the day-to-day operations of the company.
- (e) Integration of operations: The relationship between the operations of the entity and those of the person. For example in *Transport Couture*<sup>10</sup>, although the trucking company, Transport Couture, owned no shares in two other companies, it was found to have the degree of influence necessary to control in fact the two companies. Transport Couture was the only customer of the two companies, and supplied them with all management services. The two companies did not have any of their own employees nor did they have a separate business establishment from that of Transport Couture. Furthermore, a family relationship existed, as the shareholders of Transport Couture were the sons of the owners of the other two corporations.
- (f) Involvement in the strategic decisions or “raison d’être” of the entity: The role of the person in the creation of the entity (i.e., whether the person was a directing mind). For example, a person is more likely to exercise significant influence where the person played a key role in the development of the mission, purpose(s), objectives and activities of the entity or in setting out the legal or operational structure of the entity to secure all or substantially all the economic benefits of the entity.

**Influence based on economic dependence**: This refers to a person’s ability to exert economic pressure on the entity that could reasonably affect its future and/or its viability. In assessing the degree of such influence, OSFI will generally consider:

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<sup>9</sup> [2001] T.C.J. No.749 [*Mimetix*], aff’d [2003] F.C.J. No. 335 (C.A.).

<sup>10</sup> [2003] T.C.J. No. 24, aff’d [2004] F.C.J. No. 135 (C.A.).

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- (a) **Financial support:** The nature (e.g., retractable/redeemable securities, demand/term loans, subordinated debts) and size of the person’s financial support to the entity as well as its terms and conditions and the potential impact on the entity of the withdrawal of that support. For example in *Mimetix*, the court noted that the U.S. Corporation, as the debt holder in *Mimetix*’s business “was in a position to exert the kind of pressure that enabled it to have its will prevail with respect to that business”<sup>11</sup>. The court also noted that changes in economic conditions (external or internal to the company) could result in control in fact shifting from one person to another.
- (b) **Business relationship:** The nature and extent of the business relationships (i.e., where the person is the entity’s sole customer or client) and/or business arrangements (e.g., supply, management services, marketing, leasing or franchise arrangements) between the entity and the person or an entity controlled by the person. For example in *Robson Leather Company Ltd. v. M.N.R.*<sup>12</sup>, the Federal Court of Appeal noted that while Robson did not have voting control, the financial plight of one person and his company was such that Robson, who from a practical point of view, could be the only possible purchaser, was in a position to exert the kind of pressure that enabled him (Robson) to have his will prevail in the business of the other person.
- (c) **Expertise:** Influence over an entity can arise as a result of the person having unique expertise required to operate the business of the entity. For example in *L.D.G. 2000 Inc. v. Canada*<sup>13</sup>, the Tax Court noted that “It also seems clear that the know-how and influence of the directors of Gestion and Bermex were behind the appellant’s economic revival and its profitability, and this put the appellant under their control”. Dependence on a particular shareholder was also a factor in the Canadian Transport Commission’s finding (upheld by the Federal Court of Appeal) that United had control in fact of the air carrier, Okanagan Helicopters Inc<sup>14</sup>. In that case, United was the largest investor in Okanagan, Okanagan was required to enter into leasing agreements with United, and Okanagan was relying on United’s expertise and experience in the conduct of its business.

**Influence over the life of the entity:** This refers to the ability of a person to initiate the liquidation or the sale of all or substantially all of the business of the entity, or to appropriate the entity’s profits or property. For example in

- *Oakfield Developments (Toronto) Ltd. v. Minister of National Revenue*<sup>15</sup>, where voting control of a company was divided equally between one group owning the common shares and one group owning the preferred shares, the Supreme Court held that notwithstanding the equality of voting power, the group owning the common shares controlled the

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<sup>11</sup> *Ibid.* at para. 48.

<sup>12</sup> [1977] F.C.J. No. 104 (C.A.).

<sup>13</sup> *L.D.G. 2000 Inc. v. Canada*, [2002] T.C.J. No.659.

<sup>14</sup> *Okanagen Helicopters Ltd., Wescan Resource Equipment Ltd., and The Resource Service Group Ltd. v. Canadian Transport Commission and Sealand Helicopters Ltd.* (1982) 144 D.L.R. (3d) 10 (F.C.A.).

<sup>15</sup> [1971] S.C.R. 1032.

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company because they had the voting power to authorize the surrender of the company's letters patent and were entitled to the remaining properties upon wind-up after paying a fixed dividend to the preferred shareholders;

- *The Queen v. Imperial General Properties Ltd.*<sup>16</sup>, where despite a corporate reorganization resulting in equal voting power and an equal number of directors among two parties, the party who had the ability to initiate the liquidation of the entity was held to control in fact the company, and
- *Luise Zinkhofer and Bernard Zinkhofer v. M.N.R.*<sup>17</sup>, the Tax Court stated that “where there is apparent voting equality...one must look at other factors to determine control such as the right to terminate a company's existence and seize the residue of its assets.”

**Acting in Concert:** Having regard to the concept of “acting in concert” set out in the FRFI statutes<sup>18</sup>, when assessing control in fact of a FRFI or an entity that controls a FRFI, OSFI will examine whether the person is acting in concert with one or more other persons. If so, those persons' influence will be aggregated. Where their aggregate ownership stake exceeds 50%, those persons will be deemed to control in law the FRFI (i.e., control within the meaning of paragraph 3(1)(a) or (b) of the FRFI statutes). In all other cases, OSFI will assess the combined degree of direct and indirect influence exercised by the group of persons, including their aggregate ownership stake.

\* Advisories describe how OSFI administers and interprets provisions of existing legislation, regulations or guidelines, or provide OSFI's position regarding certain policy issues. Advisories are not law; readers should refer to the relevant provisions of the legislation, regulation or guideline, including any amendments that came into effect subsequent to the Advisory's publication, when considering the relevancy of the Advisory.

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<sup>16</sup> [1985] S.C.R. 288.

<sup>17</sup> (1991) 91 D.T.C. 643.

<sup>18</sup> Section 9 of the *Bank Act*, the *Trust and Loan Companies Act*, and the *Insurance Companies Act*, and section 11 of the *Cooperative Credit Associations Act* provide that where two or more persons are acting in concert, those persons are deemed to be a single person for the purposes of the ownership provisions.